

## Letter from the Executive Director

The events of last September cast a shadow over all of our activities, underscoring the precariousness of things that we have taken for granted, as well as those things that are most important in life. It is beyond my power to add to what has been stated by others that are far more eloquent than I, however, on behalf of the Commission and its staff, let me add our voices to those across the country and the world and express thanks for the bravery and fidelity that firefighters, police officers and other safety personnel, as well as our fellow citizens, demonstrated on that dark day. If that day has changed us all, one aspect of that change is a greater appreciation for the commitment and dedication of those who do us the honor of protecting our families and ourselves.

As we were preparing to release the *2000 Annual Report* PERAC met in a strategic planning session to discuss goals and objectives and review the performance of the Commission in its first few years. Over several days Commission Members and staff assessed where we were and how far we had come, and looked to the future. A consensus developed that the primary goal of PERAC is to be a service provider to retirement boards and staff. In fact, that function is specifically set forth in statute as

we are assigned by Chapter 32 duties in the disability, actuarial, audit, service restoration as well as other areas that result in the providing of substantive service to the retirement community. In setting up disability panels, performing actuarial valuations, and conducting audits, for example, PERAC assists members and boards in accessing rights or meeting duties pursuant to Chapter 32. This model of service provider rather than the model of regulator is an approach that the Commission has taken since its inception. The commitment to that approach was reinforced at the 2001 Strategic Planning Session. Following through on that commitment, PERAC recently disseminated an extensive survey to Retirement Board Members and Administrators seeking opinions regarding a variety of issues pertaining to PERAC's role and responsibilities.

The Commission also expanded its commitment to education in 2001. A minimum of two seminars will be held each year. In 2001 sessions were held regarding Ethics, the Disability Process and filing an Annual Statement. Also, an intensive educational program at the University of Massachusetts has been scheduled. This program will take place from July 28 through 31 and we strongly urge Board Members and staff to attend.



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*Executive Director*

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PERAC recently began publishing a *Web Page Update*. The Commission has devoted resources to increasing the use of the Internet as a source for factual material about the retirement systems, Chapter 32 and educational resources. In 2001 we added Chapter 32 to the Web Page with links to relevant PERAC Memos. In addition, we have worked to enable boards to use the Internet as a tool to accomplish important tasks. In this regard, the interactive pooled fund worksheet function, accessing the annual appropriation questionnaire, the buy back calculator and downloading of forms, represent our initial efforts. We hope to expand on the use of the Internet in accomplishing these and other tasks in order to assist in the administration of the systems.

Other major communication projects included a revision of all disability and general membership forms. These revisions were completed with the assistance of Board Members and staff who the Commission consulted prior to finalizing the documents. That process was a successful example of how, working together, PERAC and the retirement boards can improve the administration of our retirement systems. This will serve as a model for other similar activities. We also reformatted and disseminated

a new easy-to-read compilation of *PERAC Regulations* that will contribute to the ability of Board Members and staff to serve their members.

Two thousand and one was a year in which continued discussion of Social Security reform kept the prospect of mandatory Social Security participation at the forefront of policy concerns. The Commission at its strategic planning session reiterated its opposition to mandatory Social Security participation and through testimony, letters to prominent national figures and work with opposition groups, aided in assuring that the President's Commission on Social Security did not include such a proposal in its final report. The Commission's efforts were gratefully acknowledged by Ohio Senator George Voinovich who led the fight against mandatory coverage. Towards the end of the year PERAC aggressively pursued the legal and regulatory actions necessary to implement the provisions of the Economic Growth and Tax Relief Act of 2001. In particular, emergency regulations were issued that enabled the boards to begin the processing of buy backs of creditable service through the use of rollover distributions from IRAs, defined contribution plans and deferred compensation plans. The speedy adoption of these regulations enabled members to avail themselves of the

provisions of the new law at the earliest possible moment.

In the audit area several initiatives were undertaken to assist boards in performing their responsibilities in accordance with regulation and statute. These included a revision of the *PERAC Internal Control Questionnaire*, development of a new *Accounting Manual* and expanded staff assistance. PERAC also increased coordination between the investment and audit units and established a formalized process for following up on audit findings. These follow-up sessions have been instrumental in the correction of problems uncovered through the audit. Working together the Commission and Board Members and staff have made great strides in addressing problems in an amicable and professional manner.

One important area that we have focused on recently is review of the appropriations process and confirmation that the employer has made the appropriations to the system as required by Chapter 32. In the instance of Pittsfield, shortfalls over a period of years had resulted in an amount of \$750,000 being owed to the system. The City has recently agreed to make up that shortfall. In this instance through our efforts the rights and fiscal security of the employees and retirees in that community have been

protected. The Commission takes justifiable pride in that accomplishment.

In performing its statutory responsibility with respect to the review of earnings of disability retirees, the Commission has annually assessed reports from over 15,000 individuals. In contrast to the perception created in the media, the incontrovertible fact is that only a small percentage of these retirees have any earnings at all and those who are earning above the legal limit are an even smaller percentage. Nonetheless significant sums have been recovered for the systems by PERAC. In the 2001 reporting period, 14,593 members filed statements. A total of 3,831 statements indicated earnings and only 173 reported earnings above the limit. In that period, PERAC recovered \$814,123.33 as a result of individuals failing to file reports and \$1,486,726.20 in earnings above the limit. This total of \$2,300,849.50, when added to the amounts previously recovered, results in recoveries of \$7,458,438.30 since PERAC assumed this responsibility. The administration of this aspect of Chapter 32 has been guided by the need to be sensitive to the retirees while performing the role assigned to us. We believe that through a conscientious respect for the member PERAC has accomplished that goal. In addition to the completion of actuarial valuations, analysis

of pending legislation and developing funding schedules for a number of retirement systems, PERAC conducted the first experience study of the Massachusetts' pension plans. The *State Retirement System Experience Study* revealed that past assumptions had been conservative and that actual experience in the salary increase, disability, and withdrawal rates for active employees supported a change in assumptions that decreased cost and that mortality rates supported a change in assumptions that increased cost. Overall, assumption changes produced a total plan cost less than that under the previous assumptions. The same assumption changes were necessitated by the results of the *State Teachers' Experience Study* with the addition of a change in the rate of retirement assumption for active employees. That additional change led to a slightly greater plan cost due to assumption changes in that System. The *Local Experience Study* had findings that deviated slightly from the State and Teachers' studies. An increase in the withdrawal rate resulted in a lowering of plan cost. This more than offset an increase in retirement rates for active employees that increased plan cost. In conjunction with a decrease in the disability assumption, a decrease in the salary increase assumption and a decrease in the mortality assumption, these changes

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resulted in a decrease in total plan cost. This massive undertaking, requiring the analysis of millions of data elements spanning several years, is an accomplishment in which the Commission takes much satisfaction.

This *Annual Report* contains the investment performance for the year 2001 for all retirement systems and the PRIM Board. Not surprisingly these returns

mirrored the performance of the capital markets and for the second consecutive year, negative results were the norm. Such a development underscores the need to focus on the long-term and the wisdom of retaining actuarial investment assumptions in the 8 to 8.5% range. These assumptions are based on the long-term performance of the capital markets and in light of that, it should not be a surprise that the recent positive performance in the teens and twenty per cent range could not be sustained.

In 2001 returns ranged from +4.3% to -9.8%. No system met its actuarial assumption and thereby all systems suffered actuarial losses, however, overall returns were respectable in the context of the -4% return that would have been expected from a composite asset allocation achieving benchmark returns. Most national surveys of public pension fund performance in 2001 indicated a loss of 4% or greater. The median return (the return for the system in the middle of the pack) for the 85 systems that do not participate in PRIT was -3.1% while the median return for the State, Teachers and PRIT participants was -5.2%. The median return for all systems was -3.9%.

Two thousand and one reminded us that markets do revert to the mean, as a second year of losses followed a decade of

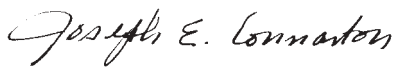
above trend equity returns and previously underperforming asset classes, subclasses, and styles continued to make dramatic comebacks. During difficult periods such as these there are no magic solutions to better returns but it is more important than ever to maintain a long-term investment horizon and to diversify the asset allocation of portfolios and insure that managers are sticking to the mandate for which they were selected.

As we look forward, it does not appear that capital markets will, in the near future, be replicating the long period of above average returns experienced virtually from the time that investment restrictions on retirement assets were removed in the 1980s until the last two years. In light of that change in the environment, boards must make every effort that system management takes place in a manner consistent with fiduciary duty. Compliance with Chapter 32 and PERAC Regulations as well as the Conflict of Interest Law is part of that fiduciary duty.

The challenges of the last few years have been largely met by the retirement boards. Investment performance has remained consistent with expectations given the market performance, new federal and state laws have been implemented smoothly and funding progress, though tem-

porarily set back, remains a top priority. PERAC is pleased to have made a contribution to these and other system accomplishments, however, as always the real credit must go to Board Members and Administrators.

Sincerely,

  
Joseph E. Connarton  
Executive Director